STATE OF CALIFORNIA
FRANCHISE TAX BOARD
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March 5, 2007

William E. Taggart Jr.
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Dear Mr. Taggart:

I am writing in response to your letter of January 26, 2007. Our legal staff reviewed your letter and the following is the response:

You express your concern that Internal Revenue Code section 66 and California Revenue and Taxation Code section 18534, which were enacted to provide relief to taxpayers who filed married filing separate tax returns, do not meet their intended purposes.

You admit that the concerns that you raise occur in less than one percent of cases. You indicate while there is no issue when couples report all of their taxable income, the problem arises when one party fails to report community income. You seek to address the situation where one party is taxable on community income, which was appropriated by the other party, and for which he/she received no benefit.

You disagree with the current basis for reporting community income under both California and federal law, which is ownership of the property. You propose that in order to avoid the current tax consequences that result when one party to a joint/married filing separate tax return does not report income, community property laws should be changed to provide that the basis for reporting income for tax purposes be based on "possession and control," unless the couple provide otherwise in a written document.

The changes you suggest are legislative changes to community property law rather than to tax law. The Franchise Tax Board is not the agency that is empowered by the Legislature to make changes to the community property provisions found in the California Family Code. Further, it is the Franchise Tax Board’s position that your proposal to amend the Family Code to change community property law to provide that the basis for reporting income for tax purposes be based on "possession and control," rather than on ownership, would not have your intended result. Such a change would result in greater disputes between the parties, and increased litigation to establish which owner of the community property had "possession and control" of the item of community property that gave rise to the unreported income. Rather than being a viable solution, the proposed change would heighten the number of controversies between taxpayers filing married filing joint and married filing separate returns, and result in more state and federal audits to determine which taxpayer had dominion and control of the item of unreported community income.

You also state in your letter that you believe that the current tax relief available pursuant to Revenue and Taxation Code section 18534 for the failure of an individual to include community property income on a married filing separate tax return is not adequate to address the problem you describe.

You mention that you are not aware of any case where the Franchise Tax Board has granted relief under Revenue and Taxation Code section 18534 to a taxpayer who had filed a married filing separate return where there was unreported community property income. Of the eight cases that the Franchise Tax Board has identified in which relief was sought under Revenue and Taxation Code section 18534, statutory relief was granted to seven of these taxpayers.

In your letter, you assert that the United States Tax Court has no jurisdiction to review the denial of relief by the IRS under Internal Revenue Code section 66 and that the section is a "wholly useless provision" for California taxpayers. You also state that you "have never heard of a case in which the IRS has granted relief to a California taxpayer under IRC §66(b) or §66(c)."

Your assertion that the United States Tax Court lacks jurisdiction to review an IRS denial of relief under Internal Revenue Code §66 is without support. Clearly, the court has exercised jurisdiction where relief is sought from a deficiency. (See Beck v. Commissioner, T.C. Memo. 2001-198 [82 T.C.M. 347].) More recently the court exercised jurisdiction where the petitioner, a California resident, sought relief under Internal Revenue Code §66(c) for self assessed amounts. (See Bennett v. Commissioner, T.C. Summary Opinion 2005-84.)

In your letter, you have noted that the State Board of Equalization did not address the basis of its jurisdiction in the either of the two cases where it addressed tax relief sought under Revenue and Taxation Code §18534. It asserted that this department would be inconsistent with the IRS if it granted relief under Revenue and Taxation Code §18534(c) "because a California taxpayer cannot qualify for relief under IRC §66."

The two State Board of Equalization cases involving the issue of relief sought under California's Revenue and Taxation Code §18534 were within the jurisdiction of that Board because the first involved an appeal from a Notice of Action upon a proposed assessment and the second was from this department's denial of a claim for refund. The assertion that inconsistency would result if this department granted relief where the Internal Revenue Service had not provided similar relief fails to recognize that taxpayers can receive relief under the federal provision. Additionally, it is clear that when relief is requested under Revenue and Taxation Code section 18534(a), the California provision modeled after Internal Revenue Code section 66(c), different factors can be considered in determining whether relief should be granted, e.g. hardship, and that this department may independently weigh factors more favorably to the party seeking relief.

Your contentions seem to be aimed more at the application and interpretation of Internal Revenue Code section 66 and federal case authority, primarily the affect of Poe v. Seaborn (1930) 282 U.S. 101. Additionally, you appear to advocate that for tax reporting purposes the responsibility for reporting income go from ownership of and interest based upon community property principles to possession and control. Such positions have been previously advanced in a 1997 Louisiana Law Review article. (See 58 La. L Rev. 309.) That article concluded that "Along with the implementation of a proportionate liability standard, Poe v. Seaborn would have to be overruled and Congress would have to preempt state community property laws." In the event federal law is changed, California could at that time, consider conforming legislation.

If you have any questions about this information, please feel free to contact me.

Sincerely,

Debbie Newcomb
Taxpayer Advocate

cc: Hon. John Chiang
Hon. Betty T. Yee
Hon. Michael C. Genest
Marcy Jo Mandel
Alan LoFaso
Anne Maitland